IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

IN RE	§	
	§	
GDH INTERNATIONAL, INC., et al.,	§	**Case No. 00-45647-BJH-11**
	§	
Debtor.	§	
	§	
RCD INVESTMENTS NO. 4, LTD.,	§	
	§	
Plaintiff,	§	
	§	
v.	§	**Adversary No. 00-4185**
	§	
FOOTHILL CAPITAL CORPORATION,	§	
	§	
Defendant.	§	

MEMORANDUM OPINION

In their respective motions for summary judgment, RCD Investments No. 4, Ltd. ("RCD4") and Foothill Capital Corporation ("Foothill") ask this Court to interpret an Amended and Restated Inter-Creditor Agreement – Subordination and Standstill Agreement dated as of July 2000 (the "Inter-Creditor Agreement") in order to determine the relative priority of their respective interests in the Debtors' Intellectual Property.[1] The Court has jurisdiction over this dispute pursuant to 28 U.S.C. §§ 1334 and 157. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (B), (D), (K), and (O). This Memorandum Opinion constitutes the Court's findings of fact and conclusions of law in accordance with Fed. R. Civ. P. 52, made applicable here by Bankruptcy Rule 7052.

[1]Capitalized terms not defined herein shall have the meaning ascribed to them in the Inter-Creditor Agreement.

A single issue controls the outcome of this dispute. Whether, pursuant to the Inter-Creditor Agreement, Foothill can prime the I.P. Liens of RCD4 as a result of its postpetition loans to the Debtors pursuant to the Interim Order Authorizing Debtors: (A) To Use Cash Collateral; (B) To Incur Postpetition Debt; and (C) To Grant Adequate Protection And Provide Security To Foothill Capital Corporation (the "Interim Financing Order") and the Final Order Authorizing Debtors: (A) To Use Cash Collateral; (B) To Incur Postpetition Debt; and (C) To Grant Adequate Protection And Provide Security To Foothill Capital Corporation (the "Final Financing Order") (hereinafter, the Interim Financing Order and the Final Financing Order are collectively referred to as the "Financing Orders").

I. Contentions of the Parties

In its motion for summary judgment, RCD4 seeks to enforce those terms of the Inter-Creditor Agreement that subordinate any I.P. Lien that Foothill "may now have and/or hereafter acquire" to RCD4's I.P. Lien, regardless of when such I.P. Lien was granted. RCD4 also seeks a determination that it is entitled to all proceeds of the Debtors' Intellectual Property to the full extent of the Debtors' indebtedness to RCD4[2]

In its cross-motion for summary judgment, Foothill seeks to enforce those terms of the Inter-Creditor Agreement pursuant to which RCD4 "expressly consents," in the event the Debtors become insolvent, to Foothill being granted "senior liens and priorities" to those liens

[2]In its motion for summary judgment, RCD4 also sought alternative relief. Specifically, RCD4 sought a determination that Section 11 of the Inter-Creditor Agreement is unenforceable and that RCD4 is entitled to all proceeds of the Debtors' Intellectual Property to the full extent of the Debtors' indebtedness to RCD4 because Section 11 is unenforceable. At the hearing on the cross-motions for summary judgment, RCD4 waived this argument and now relies solely on the Court's determination of the meaning of the Inter-Creditor Agreement as a whole.

held by RCD4 in connection with any postpetition financing provided by Foothill to the Debtors. Thus, Foothill seeks a determination that its postpetition loans to the Debtors place its postpetition liens (as defined in the Financing Orders) ahead of RCD4's I.P. Lien to the full extent of the Debtors' postpetition debt to Foothill. Foothill contends that when this Court applies Illinois rules of contract interpretation to the Inter-Creditor Agreement, it will determine that Foothill's postpetition liens pursuant to the Financing Orders are senior to RCD4's I.P. Lien.

RCD4 and Foothill both agree that they are sophisticated lenders and that consideration supports the Inter-Creditor Agreement. Both parties agree that the Inter-Creditor Agreement is not ambiguous, but disagree as to the "plain meaning" of the language used in the Inter-Creditor Agreement.

II. Procedural and Background Facts

On October 4, 1999, Foothill and the Debtors entered into a Loan and Security Agreement and related documents pursuant to which Foothill extended a term loan and a revolving loan to the Debtors in exchange for a first-priority lien on the Debtors' property. RCD4 also agreed to extend a term loan to the Debtors in return for a second-priority lien on certain of the Debtors' property on that same date. In order to establish the relative priority of their liens and other rights, Foothill and RCD4 entered into an Inter-Creditor Agreement – Subordination and Standstill Agreement (the "Original Inter-Creditor Agreement").

On July 31, 2000, the Debtors, Foothill and RCD4 entered into a series of further agreements which amended in certain respects the terms of Foothill's loans, RCD4's loans, the property which secured the loans and the relative priority of the loans. Among those agreements was Amendment No. 1 to Loan and Security Agreement between Foothill and the Debtors

pursuant to which Foothill granted certain accommodations to the Debtors that had not been extended in the original Loan and Security Agreement. Pursuant to the changes in the loans and loan priorities, Foothill and RCD4 replaced the Original Inter-Creditor Agreement with the Inter-Creditor Agreement.

The Debtors filed for relief under Chapter 11 of the United States Bankruptcy Code on October 25, 2000. On that same day, the Debtors filed their Motion for Secured Financing and Use of Cash Collateral seeking authority to use Foothill's cash collateral and to borrow additional monies from Foothill for their postpetition operations (the "Financing Motion"). After notice and hearing, this Court granted interim relief to the Debtors pursuant to the Interim Financing Order. After a final hearing on the Financing Motion, the Final Financing Order was entered. This issue to be decided here – whether Foothill can properly take a senior lien on the Intellectual Property and thereby prime RCD4's I.P.Liens – was reserved (by agreement of the parties) for later determination in both of the Financing Orders.

On December 28, 2000, RCD4 commenced this adversary proceeding by filing its "Complaint to Enforce Subordination Agreement Pursuant to 11 U.S.C. § 510(a) and for Declaratory Judgment" pursuant to which it requests a determination of the issue reserved in the Financing Orders – whether, pursuant to the Inter-Creditor Agreement, its I.P.Liens are senior to Foothill's I.P. Liens, notwithstanding Foothill's postpetition loans to the Debtors.[3]

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[3]On January 23, 2001, the Debtors and Foothill filed an "Amended Motion to Amend Final Order Authorizing Debtors: (A) To Use Cash Collateral; (B) To Incur Postpetition Debt; and (C) To Grant Adequate Protection And Provide Security To Foothill Capital Corporation and Joinder by Foothill Capital Corporation" (the "Joint Motion"), pursuant to which Foothill and the Debtors also seek a determination of the issue reserved in the Financing Orders. In the Joint Motion, Foothill and the Debtors ask this Court to stay this adversary proceeding pending an adjudication of the Joint Motion because they believe the issue is better decided in the context of the Joint Motion. The Court has elected to hear the parties' cross-motions for summary judgment, but will apply its decision here to the Joint

III. The Summary Judgment Motions

A. Requirements of Rule 56 and Bankruptcy Rule 7056.

The parties agree that this Court should enter a summary judgment where it appears from the record that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law. *See* Fed. R. Civ. P. 56(c); *Meadowbriar Home for Children, Inc. v. Gunn*, 81 F.3d 521, 533 (5th Cir. 1996) ("Summary judgment shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits if any show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law."); *Wilson v. Secretary, Dept. of Veterans Affairs*, 65 F.3d 402, 404 (5th Cir. 1995).

B. Whether Foothill Can Take a Senior Lien on the Intellectual Property.

The parties agree that there is no genuine issue of material fact in dispute, but disagree with respect to the legal conclusion they ask the Court to make – whether Foothill can take a senior lien on the Debtors' Intellectual Property in accordance with the terms of the Inter-Creditor Agreement. To make this determination, the Court is required to interpret the language of the Inter-Creditor Agreement.

1. Illinois Rules of Contract Interpretation.

The Inter-Creditor Agreement is governed by Illinois law. *See* Inter-Creditor Agreement, § 27. In *Air Safety, Inc. v. Teachers Realty Corp.*, 706 N.E. 2d 882, 884 (Ill. 1999) the Illinois Supreme Court stated:

Motion.

> An agreement, when reduced to writing, must be presumed to speak the intention of the parties who signed it. It speaks for itself, and the intention with which it was executed must be determined from the language used. It is not to be changed by extrinsic evidence.

Illinois employs the "four corners" rule in contract interpretation pursuant to which a court must first address the threshold issue of whether the contract is ambiguous. *See Bourke v. Dun & Bradstreet*, 159 F.3d 1032, 1036 (7th Cir. 1998); *Bank of Am. Nat'l. Trust and Sav. Ass'n. v. Schulson*, 714 N.E.2d 20, 24 (Ill. App. Ct. 1999), *appeal denied*, 723 N.E.2d 1161 (Ill. 1999). "If the language of the contract is facially unambiguous, then the contract is interpreted by the trial court as a matter of law without the use of parole evidence." *Air Safety*, 706 N.E.2d at 884; *see Bourke*, 159 F.3d at 1036. Parole evidence may be considered only if "the language of the contract is susceptible to more than one meeting." *Id.* Thus, where a contractual provision is clear and unequivocal, it "is not rendered ambiguous simply because parties do not agree on its meaning." *Holden v. National Boulevard Bank of Chicago*, 596 N.E.2d 47, 52 (Ill. App. Ct. 1992).

Under Illinois law a contract must be read as a coherent whole wherever possible, *see Taracorp, Inc. v. NL Indus., Inc.*, 73 F.3d 738, 745 (7th Cir. 1996), and "it is presumed that every clause in the contract was inserted deliberately and for a purpose." *Atlantic Mut. Ins. Co. v. Metron Eng'g. and Constr. Co.*, 83 F.3d 897, 900 (7th Cir. 1996). Moreover, Illinois law instructs that, wherever possible, courts "must interpret a contract in a manner that gives effect to all of its provisions." *Schulson*, 714 N.E.2d at 24. "[W]here both a general and a specific provision in the contract address the same subject, the more specific clause controls." *Grevas v. U.S. Fidelity & Guaranty Co.*, 604 N.E.2d 942, 944 (Ill. 1992). Thus, if two provisions of the Inter-Creditor Agreement are in conflict, Illinois law requires that "where one intention is

expressed in one clause of an instrument and a different, conflicting intention appears in another clause of the same instrument, effect should be given to the clause which is the more principal and specific, and the general clause should be subjected to such modification or qualification as the specific clause makes necessary." *Herrington v. J.S. Alberici Const. Co., Inc.*, 639 N.E.2d 907, 910 (Ill. App. Ct. 1994).

2. Application of these Construction Rules to the Inter-Creditor Agreement.

The parties agree that the Inter-Creditor Agreement is not ambiguous. Thus, after applying the remaining principles of contract interpretation under Illinois law, the Court concludes that Section 11 of the Inter-Creditor Agreement controls. Section 11 specifically provides that the Debtors may grant "senior" liens to Foothill "in connection with any post-petition financing" provided by Foothill. Section 11 further provides that RCD4 "consents" to the granting of such "senior" liens to Foothill to the full amount of the postpetition financing:

> [U]ntil the Senior Indebtedness has been Finally Paid, in the event an Insolvency Proceeding involving any Obligor shall occur and be continuing, Subordinated Lender [RCD4] hereby (i) expressly consents to the granting by any such Obligor to Senior Lender [Foothill] of senior liens and priorities in connection with any post-petition financing of any such Obligor by Senior Lender.

Section 11 also contains waivers by RCD4 of: (i) any "adequate protection" argument it might have in an insolvency proceeding, and (ii) any "claim or defense" it might have with respect to Foothill's decision to consent to the use of cash collateral and/or loan monies to the Debtors pursuant to Sections 363 and/or 364 of the Bankruptcy Code (such as the Financing Orders entered in these cases):

> In the event that Subordinated Lender has or at any time acquires any security for the Subordinated Indebtedness, Subordinated Lender agrees not to assert any right it may have to "adequate protection" of its interest, if any, in such security in any

> Insolvency Proceeding of any Obligor . . . Subordinated Lender waives any claim or defense Subordinated Lender may now or hereafter have arising out of the election by Senior Lender in any Insolvency Proceeding involving any Obligor instituted under Chapter 11 of the Bankruptcy Code of any use of cash collateral, any borrowing or any grant of a security interest under Section 363 and/or 364 of the Bankruptcy Code, or similar provisions of Canadian law, by any Obligor, as debtor-in-possession.

These provisions of Section 11 are narrowly tailored to the precise circumstance at issue here, where the Debtors are in bankruptcy and have obtained postpetition financing from Foothill secured by postpetition liens, including a "senior" lien on the Intellectual Property.[4] In contrast, the remainder of the Inter-Creditor Agreement, including the provisions relied on by RCD4, provides the general rules which govern the prepetition relationship between the parties.

However, the Court will analyze each of the provisions of the Inter-Creditor Agreement relied upon by RCD4 and explain why those provisions are not controlling here. While RCD4 points to language from other sections of the Inter-Creditor Agreement to support its interpretation of the agreement, RCD4 essentially contends that Sections 2 and 7 of the Inter-Creditor Agreement are the controlling provisions. Section 2 provides, *inter alia*:

> Senior Lender agrees that any I.P. Lien it may now have and/or hereafter acquire shall be subordinate and subject to the Subordinated Lender's I.P. Lien regardless of the order or time as of which any such I.P. Lien attached. . . .

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[4]RCD4 also contends that its I.P. Lien cannot be primed because its "interests in the I.P. Lien could [not] be adequately protected against priming by Foothill. Indeed, the Debtors never even tried to offer any adequate protection." Complaint at ¶ 18. RCD4 further contends that its agreement in Section 11 of the Inter-Creditor Agreement "not to assert any right it may have to 'adequate protection' of its interests" is not at issue here because Section 364(d) of the Bankruptcy Code mandates a finding of adequate protection before a priming lien can be granted – it did not have to assert a right to adequate protection. The Court disagrees. Before a priming lien can be granted, Section 364(d)(1) requires that the trustee (or debtor-in-possession) be unable to obtain such credit otherwise and that the interest being primed be adequately protected. Here, the Court found in the Financing Orders that credit was not available on lesser terms. *See* Interim Financing Order ¶ G; Final Financing Order ¶ G. However, no adequate protection finding is required in light of RCD4's waiver of its right to adequate protection and its further waiver of any claim or defense to Foothill's postpetition loans to the Debtors.

Inter-Creditor Agreement, § 2, p. 4.

When read in concert with Section 11, and after applying the Illinois doctrine that all contract provisions should be harmonized and given effect wherever possible, the language relied upon by RCD4 can only be read to mean one thing – that Section 2 establishes the order of priorities with respect to I.P. Liens granted to Foothill as a result of its prepetition financing of the Debtors. In contrast, Section 11 governs in the narrow instance where Foothill has provided postpetition financing to the Debtors and has been granted "senior liens," including senior I.P. Liens, to secure that postpetition financing. The purpose of Section 11 is clear – as part of an insolvency proceeding, the Debtors may need to borrow monies to operate. Foothill bargained for the right to have "senior liens and priorities" over RCD4 under those circumstances, including the right to have a senior lien with priority over RCD4's I.P. Lien.

RCD4 contends that this reading of Section 11 renders the "now have and/or hereafter acquire" language of Section 2 meaningless. The Court disagrees. As described above, Section 2 can reasonably be read to govern the priorities between Foothill and RCD4 with respect to financing that was in place at the time the Inter-Creditor Agreement was executed – *i.e.*, prepetition financing. Thus, Section 2 provides that any I.P. Liens granted by the Debtors to Foothill "now or hereafter" for its prepetition financing, including prepetition and postpetition liens arising from that financing, will be subordinate to RCD4's I.P. Liens. Section 2 does not govern I.P. Liens granted to Foothill for postpetition financing – Section 11 specifically governs in that circumstance.

RCD4 next contends that Section 2, not Section 11, is the more "specific" provision in the Inter-Creditor Agreement. Specifically, RCD4 contends that the language "senior liens and

priorities" for "post-petition financing" is too general. Contrary to RCD4's contention, the language in Section 11 is not vague or too general. In fact, that language mirrors the actual language of Section 364(d) of the Bankruptcy Code which governs postpetition financing in a bankruptcy case. Section 364(d) uses the phrase "senior or equal lien" without defining it. No definition is necessary – the language of the Code is simple and unambiguous, as is the language of the Inter-Creditor Agreement.

RCD4 next contends that Section 7(B)'s "notwithstanding any provisions contained herein to the contrary" language "trumps" the provisions of Section 11. Section 7(B) provides:

> Notwithstanding any provisions contained herein to the contrary, Senior Lender and Subordinated Lender agree that Subordinated Lender may exercise its Lender Remedies upon the existence of a "Primary Default" (as defined in this Section 7B). With respect to the Shared Property, Subordinated Lender agrees that it will only exercise its Lender Remedies against the I.P. Liens. Upon its election to exercise such Lender Remedies, Subordinated Lender may issue a notice to Senior Lender that it wishes to have the provisions of Section 7(C) applied ("Triggering Notice") with respect to the Franchise Lock Box and exercise its Lender Remedies against the I.P. Liens to the extent such enforcement would not in Senior Lender's reasonable determination adversely affect Senior Lender's ability to use the Intellectual Property to dispose of the Shared Property in connection with the exercise by Senior Lender of its Lender Remedies. In furtherance thereof, Subordinated Lender agrees that it will provide Senior Lender, or cause NB Trademarks, Inc. or any other third party to provide Senior Lender, with sufficient licenses, usage rights or other access to the Intellectual Property to enable Senior Lender to complete the manufacturing, processing, finishing and/or selling of any Inventory in connection with the exercise by Senior Lender of its Lender Remedies free of royalty or other payment obligations. As used in this Section 7(B), a "Primary Default" means any default under the First Subordinated Documents in the payment of any scheduled payment of interest or fees beyond the applicable cure period.

Inter-Creditor Agreement, § 7(B), p. 8.

RCD4 contends that a grant of "senior" liens pursuant to Section 11 would not allow it to "exercise its Lender Remedies against the I.P.Liens" in contravention of Section 7(B). The

Court disagrees. Section 7(B) can reasonably be read to deal with the parties' respective rights to use their "Lender Remedies," without affecting how proceeds realized from the exercise of those Lender Remedies must be distributed pursuant to other provisions of the Inter-Creditor Agreement (*i.e.*, Section 2 in connection with prepetition liens and Section 11 in connection with postpetition liens).

For these reasons, the Court concludes that Foothill is entitled to a senior lien on the Debtors' Intellectual Property pursuant to the Financing Orders and Section 11 of the Inter-Creditor Agreement. Foothill's I.P.Lien shall be senior to RCD4's I.P. Lien to the extent of its postpetition loans to the Debtors.[5] A judgment consistent with this Memorandum Opinion will be entered separately.

Signed this 2nd day of April, 2001.

Barbara Houser
United States Bankruptcy Judge

[5]If a dispute exists over the extent of postpetition financing authorized by the Court in the Financing Orders, that issue is reserved for later determination.